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IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF ARIZONA

American Family Mutual Insurance Company,	No. CV09-968-PHX-JAT
Plaintiff,	<b>ORDER</b>
vs.	
Spectre West Builders Corporation; Mountain Vista Villas Homeowners Association, Inc.,	
Defendants.	

Pending before the Court are Plaintiff American Family Mutual Insurance Company's Motion for Summary Judgment (Doc. 37), Defendant Mountain Vista Villas Homeowners Association's Cross Motion for Summary Judgment (Doc. 38), and Plaintiff's Motion to Strike Defendant's Affidavits (Doc. 65). The Court now rules on the Motions.

**I. BACKGROUND**

Defendant Spectre West Builders Corporation ("Spectre")<sup>1</sup> constructed the Mountain Vista Villas (the "MVVs"), a 73-unit condominium complex in Pinal County, Arizona. Plaintiff American Family Mutual Insurance Company ("American Family") insured Spectre under commercial general liability policies at various times between July 3, 1999 and September 9, 2008. Defendant Mountain Vista Villas Homeowners Association, Inc. (the

<sup>1</sup>The Court has entered default against Spectre for failure to appear in this action.

1 “Association”) is an Arizona non-profit corporation formed in 2003 that is responsible for  
2 the common elements of real property at the MVVs.

3 Spectre undertook construction of the MVVs between 2004 and 2006. Spectre turned  
4 the condos over to the Association on May 1, 2006. The Association alleged that Spectre  
5 committed various defects in construction of the MVVs. Pursuant to the terms of the  
6 Amended and Restated Condominium Declarations for the MVVs, the Association instituted  
7 an arbitration against Spectre in May 2008 to resolve the construction defect issues.

8 American Family defended Spectre in the arbitration under a reservation of rights.  
9 At the arbitration, the Association submitted expert witness reports to prove improper  
10 construction and resultant damages, including water damage, as well as the cost to repair or  
11 remedy the defective construction and the water damage. No transcript from the arbitration  
12 hearing exists, but the parties stipulated certain evidence into the record. In a stipulation  
13 dated April 8, 2009, Spectre and the Association stipulated to the authenticity, foundation,  
14 and admissibility of the following documents:

- 15 1. CC&R’s of Mountain Vista Villas and amendments.
- 16 2. All job files, photographs and expert reports for plaintiff’s and  
17 defendant’s experts.
- 18 3. All correspondence between counsel, between counsel and the  
19 developer and between the developer and the Association.
- 20 4. All plans and specifications.
- 21 5. All documents disclosed by either party
- 22 6. All disclosure statements and pleadings.
- 23 7. All deposition transcripts of any witness taken in this matter by either  
24 plaintiff or defendant.

(Doc. 39 Ex.M.)

25 The Arbitrator, Larry Fleischman, Esq., issued an Arbitration Under Advisement  
26 Ruling on May 21, 2009, in which he found the following costs of repair for the various  
27 claims:

- 28 1. Roofs - \$50,000

2. Decks - \$75,000
3. Sliders - \$25,000
4. Exterior Stairs and landings - \$16,295.53
5. One coat plaster - \$4,071.44
6. Exterior doors - \$25,000
7. Fire resistive construction (extrapolation re claim defect found) - \$1,442,287.99
8. Wallboard - \$1,055.20
9. Miscellaneous architectural - \$15,000
10. Windows (partial extrapolation found re lack of flashing) - \$100,000
11. Structural - \$50,000
12. Plumbing (failure of proof as to number of defective Sterling tubs, as well as code violation) - \$5,000
13. HVAC (extrapolation not established) - \$10,000
14. Reserve claim - \$20,000
15. Fees and costs - Plaintiff shall provide a fee and cost breakdown and defendant has ten (10) days to respond, at which time the matter will be taken under advisement.

(Doc. 39 Ex.K.) The Arbitrator did not indicate which portion of the repair costs was allocated to repair the defective construction and which portion was allocated to repair property damage, such as water damage, caused by the defective construction.

The Arbitrator issue his final award on June 30, 2009. (Doc. 39 Ex.J.) The Arbitrator awarded \$1,838,710.16 in damages to the Association against Spectre. (Id.) The Arbitrator further found that the Association was entitled to “its taxable costs, expert fees and attorney’s fees (pursuant to Section 11.5(k) of the Declaration, A.R.S. §12-1364, A.R.S. §12-341.01 and A.R.S. §12-322).” (Id.) He therefore awarded the Association \$300,000 in attorneys’ fees and \$259,475.65 in costs. (Id.)

The Association requested confirmation of the arbitration award pursuant to A.R.S. §12-1511. Judge Figueroa of the Pinal County Superior Court confirmed the award and

1 entered judgment for the Association against Spectre in the amount of \$2,398,185.81 on  
2 August 5, 2009. (Doc. 39 Ex.L.)

3 American Family instituted this declaratory judgment action to determine insurance  
4 coverage for the Association's underlying construction defect claims against Spectre. In its  
5 Complaint, American Family asks the Court to declare that no coverage exists for the  
6 Association's claims against Spectre because: there was no "occurrence" as defined by the  
7 policy during the policy period; no "property damage" occurred as defined by the policy; the  
8 alleged damages fall within the exclusion for damage to property; the alleged damages fall  
9 within the exclusion for damage to work; and the alleged damages fall within the exclusion  
10 for damage to impaired property or property not physically injured. (Doc. 1, p.9.) American  
11 Family further asks the Court to declare the Policy does not provide coverage for the  
12 Association's attorneys' fees and non-taxable expenses. (Id.)

13 American Family filed its Motion for Summary Judgment on June 30, 2010. (Doc.  
14 37.) It argues that the Court should find as a matter of law that Spectre's insurance policies  
15 do not provide coverage for the arbitration award obtained by the Association because the  
16 Association cannot prove an "Occurrence" or "Property Damage" under the policies and  
17 cannot prove that resulting damage occurred during any of the policy periods. American  
18 Family also wants the Court to declare as a matter of law that the policies do not cover the  
19 Arbitrator's award of attorneys' fees and non-taxable costs.

20 The Association filed its own Motion for Summary Judgment. (Doc. 38.) The  
21 Association asks the Court to hold as a matter of law that American Family is legally  
22 obligated to indemnify Spectre for the Pinal County Superior Court's judgment of  
23 \$2,398,000. The Association argues that no issue of material fact exists regarding property  
24 damage occurring at the MVVs that arose out of an occurrence during the policy periods.

25 American Family filed a Motion to Strike (Doc. 65) the affidavits attached to the  
26 Association's Reply in Support of Summary Judgment (Doc. 59). American Family argues  
27 that the affidavits contain opinions that were not timely or properly disclosed and set forth  
28 facts and opinions raised for the first time in a reply pleading.

## II. MOTION TO STRIKE

American Family moves to strike the affidavits of Ron Risto, dated August 2, 2010, and Carl Josephson, dated August 4, 2010, that it claims were filed with the Association's Reply in Support of its Motion for Summary Judgment (Doc. 59). The Reply references the affidavits of Josephson and Ron Risto, but the only affidavit that the Association actually attached to its Reply is an affidavit of Mr. Risto (Doc. 59-2 Ex.A).

On the same day it filed the Reply, August 16, 2010, the Association also filed something that it denominated "Notarized Affidavits in Support of Defendant's Response to Plaintiff's Motion for Summary Judgment" (Doc. 60), which may have confused American Family. The Association originally attached un-notarized affidavits of Carl Josephson, Ron Risto, and Larry Fleischman to its Response in Opposition to Plaintiff's Motion for Summary Judgment. The second filing on August 16, 2010 (Doc. 60) only provided notarized copies of those three affidavits.

Pursuant to 28 U.S.C. §1746, parties do not have to submit notarized affidavits in support of or opposition to motions for summary judgment if they submit unsworn declarations that substantially comply with the following form: "I declare under penalty of perjury that the foregoing is true and correct. Executed on (date). (Signature)." 28 U.S.C. §1746(2). The original affidavits of Josephson, Risto, and Fleischman were dated and signed, but did not contain the statement "I declare under penalty of perjury that the foregoing is true and correct." The Court need not determine whether the original affidavits substantially complied with the statute because Plaintiff did not object to their form and the Association has since cured the mistake. The Court will not strike the affidavits for that particular reason.

The Court, however, will strike the affidavit of Ron Risto that was actually attached to the Reply. Local Rule of Civil Procedure 7.2(m)(1) provides that a party may file a motion to strike only if it is authorized by statute or rule *or if the party seeks to strike any part of a filing on the ground that it is not authorized by statute, rule, or court order.* (emphasis added). The undersigned has held that local procedural rules do not allow parties

1 to attach additional exhibits to replies in support of summary judgment, which is “consistent  
 2 with the moving party’s need to show no genuine issue of material facts exists and that there  
 3 is no need for a trier of fact to weigh conflicting evidence, assuming the non-moving party’s  
 4 evidence is true.” *Kinally v. Rogers Corp.*, No. CV06-2704, 2008 WL 572870 \*2 (D.Ariz.  
 5 Dec. 12, 2008)(citing *EEOC v. TIN Inc.*, 2008 WL 2323913 at \*1 (D.Ariz. June 2, 2008)).  
 6 Because the Ron Risto affidavit attached to the Association’s Reply is not allowed by rule,  
 7 the Court will grant American Family’s Motion to Strike it.

8 The Court also will grant the Motion to Strike Mr. Josephson’s affidavit, even though  
 9 the affidavit is attached to the Association’s Response, rather than its Reply. The  
 10 Association never disclosed Mr. Josephson as an expert witness and its deadline for  
 11 disclosing expert witnesses passed long ago.

12 Federal Rule of Civil Procedure 37 (c)(1) automatically excludes any evidence that  
 13 is not properly disclosed, unless the failure to disclose is substantially justified or harmless.  
 14 *Yeti by Molly Ltd. v. Granville*, 259 F.3d 1101, 1106 (9<sup>th</sup> Cir. 2001). The party attempting  
 15 to introduce the evidence has the burden of proving justification or harmlessness. *Id.* at  
 16 1107. The Court finds that the Association has not demonstrated substantial justification or  
 17 harmlessness for failing to disclose Mr. Josephson. The Court therefore will strike both the  
 18 un-notarized and notarized affidavits of Mr. Josephson.

19 American Family has not moved to strike the affidavit of Ron Risto attached to the  
 20 Association’s Response. The Court notes that it will consider Mr. Risto’s report from the  
 21 underlying arbitration. The Court cautions, however, that it will not consider any additional  
 22 expert opinions by Mr. Risto that were not properly disclosed in this case.

### 23 **III. CROSS MOTIONS FOR SUMMARY JUDGMENT**

#### 24 **A. LEGAL STANDARD**

25 Summary judgment is appropriate when “the movant shows that there is no genuine  
 26 dispute as to any material fact and the movant is entitled to judgment as a matter of law.”  
 27 Fed. R. Civ. P. 56(a). Thus, summary judgment is mandated, “...against a party who fails to  
 28 make a showing sufficient to establish the existence of an element essential to that party’s

case, and on which that party will bear the burden of proof at trial.” *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

Initially, the movant bears the burden of pointing out to the Court the basis for the motion and the elements of the causes of action upon which the non-movant will be unable to establish a genuine issue of material fact. *Id.* at 323. The burden then shifts to the non-movant to establish the existence of material fact. *Id.* The non-movant “must do more than simply show that there is some metaphysical doubt as to the material facts” by “com[ing] forward with ‘specific facts showing that there is a genuine issue for trial.’” *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986) (quoting Fed. R. Civ. P. 56(e)). A dispute about a fact is “genuine” if the evidence is such that a reasonable jury could return a verdict for the nonmoving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). The non-movant’s bare assertions, standing alone, are insufficient to create a material issue of fact and defeat a motion for summary judgment. *Id.* at 247-48. However, in the summary judgment context, the Court construes all disputed facts in the light most favorable to the non-moving party. *Ellison v. Robertson*, 357 F.3d 1072, 1075 (9<sup>th</sup> Cir. 2004).

## **B. COVERAGE FOR REPAIRS**

The interpretation of an insurance contract is a question of law. *Wilshire Ins. Co. v. S.A.*, 227 P.3d 504, 506 (Ariz. Ct. App. 2010). In Arizona, courts interpret insurance policies according to their plain and ordinary meaning, from the viewpoint of an individual untrained in law or business. *Desert Mountain Props. Ltd. P’ship v. Liberty Mut. Fire Ins. Co.*, 236 P.3d 421, 427 (Ariz. Ct. App. 2010). If a policy appears ambiguous, courts consider legislative goals, social policy, and the transaction as a whole. *Id.* A policy “is ambiguous if it is subject to conflicting reasonable interpretations.” *Id.* (omitting internal citations).

Generally, the insured has the burden of establishing coverage under an insuring clause. *Keggi v. Northbrook Prop. & Cas. Ins. Co.*, 13 P.3d 785, 788 (Ariz. Ct. App. 2000). The insurer has the burden of proving the applicability of any exclusion. *Id.*

The Spectre insurance policies at issue provide coverage for “property damage” that



is caused by an “occurrence.” The Coverages section of the policies reads:

SECTION 1 - COVERAGES

COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages. However, we will have no duty to defend the insured against any “suit” seeking damages for “bodily injury” or “property damage” to which this insurance does not apply. We may, at our own discretion, investigate any “occurrence” and settle any claim or “suit” that may result.

...

b. This insurance applies to “bodily injury” and “property damage” only if:

(1) The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory”; and

(2) The “bodily injury” or “property damage” occurs during the policy period.

(Doc. 50 Ex 7.) The policies define an “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” (Id.) They define “property damage” in pertinent part as “[p]hysical injury to tangible property, including all resulting loss of use of that property” or “[l]oss of use of tangible property that is not physically injured.” (Id.)

Arizona courts have addressed whether this type of general commercial liability policy covers construction defects. In *United States Fidelity & Guaranty Corporation v. Advance Roofing and Supply Co.*, the insurer sought a declaration that it had no duty under a comprehensive general liability policy to defend an action against its insured. 788 P.2d 1227, 1228 (Ariz. Ct. App. 1990). The policy at issue in *Advance Roofing* had substantially the same language as the policies here. *Id.*

The insured in *Advance Roofing* was a roofing company that failed to replace roofs per its contract with a home owners’ association. *Id.* The association sued the company for



1 breach of contract. *Id.* The roofing company tendered defense of the action to its insurer,  
2 which filed the declaratory judgment action. *Id.* at 1229.

3 The Arizona Court of Appeals noted that the complaint against the roofing company  
4 and others did not specifically allege any property damage, only faulty workmanship. *Id.* at  
5 1233. The roofing company did not address whether the damages resulting from faulty  
6 workmanship could be covered “property damages,” but instead argued faulty workmanship  
7 itself constitutes an “occurrence” under the policy. *Id.* The *Advanced Roofing* court held,  
8 “[M]ere faulty workmanship, standing alone, cannot constitute an occurrence as defined in  
9 the policy, nor would the cost of repairing the defect constitute property damages.” *Id.*

10 Subsequent decisions have made clear, however, that physical damage caused by  
11 faulty workmanship can constitute an occurrence under a commercial liability policy. *See,*  
12 *e.g., Lennar Corp. v. Auto-Owners Ins. Co.*, 151 P.3d 538, 545-46 (Ariz. Ct. App.  
13 2007)(holding insurer had to defend insured where underlying plaintiffs alleged damage  
14 resulting at least in part from faulty workmanship, including cracks in the walls, baseboard  
15 separation, and floor tile grout cracks and separation). “[A]lthough costs incurred to repair  
16 a construction defect normally are not covered, damage to other property caused by or  
17 resulting from the defect may be covered.” *Desert Mountain*, 236 P.3d at 441. So, while  
18 the policies do not cover the costs to repair the construction defects at the MVVs, they could  
19 cover property damage resulting from the faulty construction.

20 The Association submitted expert reports at the arbitration that outlined the alleged  
21 property damage. For example, under the heading “Sliding Glass Doors,” the R.H. Adcock  
22 Defect Report lists the defect as a sliding glass door system failure, which resulted in water  
23 intrusion “causing damage to structural components, exterior and interior finishes.” (Doc.  
24 45 Ex.2, pp.37-38.) The Adcock Report also notes that the windows were not properly  
25 weatherproofed. (*Id.*, p.61.) As a result, there were drywall cracks, drywall stains, and  
26 framing stains from water intrusion. In another category called “Wallboard,” the Adcock  
27 Report lists wallboard cracking and staining as damage and the only recommendations were  
28 to repair interior stains “with Kilz primer” and to paint the entire ceiling. (*Id.*, pp.52-53.)

1           The Court finds that these reports establish that property damage resulting from faulty  
2 workmanship occurred at the MVVs. Further, categories like “Wallboard” – where the only  
3 repair recommendations clearly indicate resultant property damage and the Arbitrator  
4 specifically awarded damages for that category – demonstrate that at least part of the  
5 Arbitrator’s damages were awarded to repair resultant property damage and not just to fix  
6 faulty construction.

7           The Court also finds sufficient evidence that the damage occurred during the policy  
8 periods. The nature of an occurrence policy is to provide coverage for all occurrences during  
9 a policy period, including incremental damage. *Lennar*, 151 P.3d at 548-49. Insurers must  
10 provide coverage for ongoing property damage. *Id.* American Family insured Spectre at  
11 various times from July of 1999 to September of 2008 under commercial general liability  
12 policies. Construction of the MVVs took place between 2004 and 2006. Spectre turned the  
13 condos over to the Association in May of 2006, and the Association instituted the Arbitration  
14 in May of 2008, after finding numerous defects. The Court finds sufficient evidence that  
15 ongoing and incremental property damage occurred during the policy periods, specifically  
16 at least the policies in effect from February 8, 2006 to April 8, 2006 and August 15, 2007 to  
17 August 15, 2008.<sup>2</sup>

18           Based on the foregoing, the Court can award partial summary judgment to the  
19 Association and to American Family. The Court finds that the Spectre liability policies  
20 provide coverage for the portion of the arbitration damages meant for resultant damage  
21 repairs. On this record, however, the Court cannot determine how much of the award was  
22 intended for repair of resultant damage, like wall cracks, mold, and water staining.

23           The finder of fact must determine the precise amount of coverage for compensatory  
24 damages. The Court, of course, will not disturb the underlying arbitration award. The  
25

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26           <sup>2</sup>The August 15, 2007 to August 15, 2008 policy period encompasses the time period  
27 immediately preceding the arbitration. The detailed Adcock Defect and Repair  
28 Recommendation Report, which was based on prior visits to the MVVs was prepared in  
September of 2008.

1 Association cannot recover more than the total damages awarded by the Arbitrator and  
 2 cannot recover in any category of damages more than the Arbitrator set out for that category  
 3 in his May 21, 2009 Arbitration Under Advisement Ruling.

4 When reviewing the pending Motions, the Court did not consider the affidavit of the  
 5 Arbitrator, Mr. Fleischman. Nor will the Court allow Mr. Fleischman to testify to clarify or  
 6 elaborate on his Award. “When arbitrators have once made an award their office is at an end.  
 7 They cannot afterwards correct mistakes by a new award, or explain it by affidavit. Any  
 8 construction given to it must rest on what is apparently in the original award.” *Alexander v.*  
 9 *McNear*, 28 F. 403, 406 (C.C.D.Cal. 1886). Parties cannot call on arbitrators to explain  
 10 anything “vague and uncertain in their award.” *Id.*; see generally Reuben I. Friedman,  
 11 Annotation, *Admissibility of Affidavit or Testimony of Arbitrator to Impeach or Explain*  
 12 *Award*, 80 A.L.R.3d 155, §15 (1977).

### 13 C. COVERAGE FOR ATTORNEYS’ FEES AND COSTS

14 Along with awarding repair damages, the Arbitrator awarded \$300,000 in attorneys’  
 15 fees and \$259,475.65 in costs to the Association pursuant to Section 11.5(k) of the  
 16 Declaration, A.R.S. §12-1364, A.R.S. §12-341.01, and A.R.S. §12-322. American Family  
 17 argues that the insuring clause does not cover attorneys’ fees and non-taxable costs.  
 18 Alternatively, American Family argues that attorneys’ fees and non-taxable costs are  
 19 excluded by the “Contractual Liability” section of the policies.

20 The insuring agreements provide that American Family will “pay those sums that the  
 21 insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property  
 22 damage’ to which this insurance applies.” (Doc. 50 Ex.7.) The policies define “bodily  
 23 injury” and “property damage,” but not “damages.” The issue before the Court is not  
 24 whether attorneys’ fees and costs can be characterized as “property damage,” but whether  
 25 they can be characterized as damages that Spectre became legally obligated to pay *because*  
 26 *of* property damages.

27 American Family asserts that *Columbia Casualty Co. v. United States Fidelity &*  
 28 *Guaranty Co.*, 870 P.2d 1200 (Ariz. Ct. App. 1994) stands for the proposition that attorneys’

1 fees cannot constitute damages under a liability policy. In *Columbia Casualty*, in the  
2 underlying litigation, the primary insurance carrier caused the insured to sue a third party,  
3 in an unsuccessful attempt to shift liability. *Id.* at 1201. The third party obtained summary  
4 judgment and an award of attorneys' fees against the insured. *Id.* The primary insurer  
5 treated payment of the attorneys' fee award as payment of insurable damages, which when  
6 added to earlier payments on the policy, exceeded the \$100,000 primary limit and thereby  
7 triggered the excess coverage. *Id.*

8 The question before the Arizona Court of Appeals was whether the payment of the  
9 attorneys' fees award to the successful third-party defendant should be considered a liability  
10 payment under the policy. *Id.* The appeals court held:

11 We do not see how such payments can be treated as something  
12 the insured was legally obligated to pay as damages because of  
13 property damage. Seeking unsuccessfully to shift liability to a  
14 third person for property damages does not make sums due that  
15 third person damages caused by the original property damages.  
16 The attorneys' fees are damages caused by the insurer's  
17 incorrect assessment of the liability of the third person it, in the  
18 exercise of its exclusive control of the insured's defense, chose  
19 to sue. The price of a failed defense undertaken in part to allow  
20 the insurer to escape its obligation to pay for the insured's  
21 liabilities cannot be that the insured will have lost its protection.  
22 Consequently, we believe it proper to treat the attorneys' fees  
23 award as "expenses incurred by the Company" or "costs taxed  
24 against the insured in any suit defended by the Company," both  
25 of which under the policy in issue the insurer is obligated to pay  
26 in addition to liability payments.

19 *Id.*

20 But the appeals court went on to distinguish the situation here. The primary insurer  
21 in *Columbia Casualty* relied on an Eastern District of Michigan case for the proposition that  
22 an attorneys' fee award is covered by a general liability policy. In response to that argument,  
23 the appeals court stated, "That award was to the plaintiff suing the insured and thus was a  
24 liability arising from the insured event." *Id.* The Arbitrator's award of attorneys' fees and  
25 costs was to a plaintiff, the Association, suing the insured, Spectre, which the *Columbia*  
26 *Casualty* court described as a "liability arising from the insured event." *Id.* Thus, if  
27 anything, *Columbia Casualty* supports coverage for the Association's attorneys' fees and  
28 costs.

The Court finds that the insuring language is broad enough to encompass coverage for the Arbitrator's award of attorneys' fees and costs to the Association. The Court already has held that property damage occurred under the policies, and Spectre became legally obligated to pay attorneys' fees and costs as a result of that property damage. The Court therefore finds that the attorneys' fees and costs awarded at the arbitration are damages that fall under the insuring clause of the policies. *Cf. Desert Mountain*, 236 P.3d at 436 ("[S]uch costs and expenses, including attorneys' fees, should be treated as the legal consequences of the original wrongful act and may be recovered as damages.")(internal citations omitted).

The Court now must determine whether coverage for the attorneys' fees and non-taxable costs<sup>3</sup> is defeated by an exclusion. American Family argues that the following provision in the policies excludes coverage for attorneys' fees and costs because the Association's right to attorneys' fees arose out of contract:

**2. Exclusions**

This insurance does not apply to:

...

**b. Contractual Liability**

"Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of the liability in a contract or agreement. This exclusion does not apply to liability for damages:

(1) That the insured would have in the absence of the contract or agreement; or

(2) Assumed in a contract or agreement that is an "insured contract" provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an "insured contract", reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of "bodily injury" or "property damage", provided:

(a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and

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<sup>3</sup>American Family concedes that it must cover all of the Association's taxable costs.

1 (b) Such attorney fees and litigation expenses are for  
2 defense of that party against a civil or alternative dispute  
3 resolution proceeding in which damages to which this insurance  
4 applies are alleged.

(Doc. 50 Ex.7.)

5 The Court finds that the plain language of the exclusion negates Defendant's  
6 argument. The exclusion provides that the Policy will not apply to "bodily injury" or  
7 "property damage" for which the insured has to pay damages because of the assumption of  
8 liability in a contract or agreement. The Court has held that attorneys' fees and non-taxable  
9 costs qualify as damages an insured becomes legally obligated to pay *because of* "bodily  
10 injury" or "property damages." But the Court does not find that attorneys' fees and non-  
11 taxable costs qualify as "property damage," as defined by the Policy, which is required for  
12 the exclusion to apply. Alternatively, even if attorneys' fees constitute "property damage"  
13 under the Policy, the fees were not imposed on Spectre by reason of its "assumption of the  
14 liability in a contract or agreement." Rather, the fees were imposed by operation of statute.

15 Moreover, the Arizona Court of Appeals, recently confirmed that exclusions like the  
16 one above do not encompass all contracts, regardless of their nature. *Desert Mountain*, 236  
17 P.3d at 432 (internal citations omitted). Rather, the contractual liability exclusions apply  
18 only to "the assumption of another's liability, such as an agreement to indemnify or hold  
19 another harmless." *Id.* The contractual liability exclusion therefore does not bar coverage  
20 of the Association's attorneys' fees and costs. Because the insuring clause covers the award  
21 of attorneys' fees and costs and because no exclusion applies, the Court holds as a matter of  
22 law that the policies cover the Arbitrator's award of \$300,000 in attorneys' fees and  
23 \$259,475.65 in costs.

24 Accordingly,

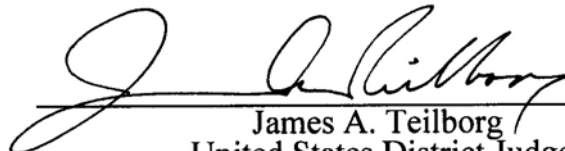
25 **IT IS ORDERED** GRANTING Plaintiff American Family's Motion to Strike (Doc.  
26 65). The Clerk shall strike the affidavit of Ron Risto attached to the Defendant's Reply in  
27 Support of its Motion for Summary Judgment (Doc. 59). The Clerk also shall strike the un-  
28 notarized affidavit of Carl Josephson that was attached to the Defendant's Response in

1 Opposition to Motion for Summary Judgment (Doc. 58) as well as the notarized version of  
2 Mr. Josephson's affidavit that the Association filed separately at Docket 60.

3 **IT IS FURTHER ORDERED** GRANTING IN PART AND DENYING IN PART  
4 American Family's Motion for Summary Judgment (Doc. 37). The Motion is granted to the  
5 extent that the Court finds that the Spectre liability policies do not provide coverage for  
6 whatever portion of the arbitration award covers the repair of construction defects at the  
7 MVVs. The Motion is denied to the extent that the Court finds that the Spectre policies do  
8 provide coverage for whatever portion of the Arbitration Award covers the repair of property  
9 damage caused by the construction defects; such amount to be determined by the fact finder.  
10 The Motion is further denied to the extent that the Court finds the policies cover the  
11 Association's attorneys' fees and costs.

12 **IT IS FURTHER ORDERED** GRANTING IN PART AND DENYING IN PART  
13 Defendant Association's Motion for Summary Judgment (Doc. 38). The Motion is denied  
14 to the extent that the Court finds that the policies do not provide coverage for the total  
15 amount of repair damages awarded to the Association in the Arbitration because the policies  
16 do not cover the costs to repair construction defects. The Motion is granted to the extent that  
17 the Court finds that the policies do provide coverage for whatever portion of the Arbitration  
18 Award covers the property damage caused by the construction defects, with such amount to  
19 be determined later by the fact finder. The Motion is further granted to the extent that the  
20 Court finds as a matter of law that the policies provide coverage for the Arbitrator's award  
21 of \$300,000 in attorneys' fees and \$259,475.65 in costs.

22 DATED this 4th day of February, 2011.

23  
24  
25   
26 James A. Teilborg  
27 United States District Judge  
28